MARKET OVERVIEW

What can I say that hasn’t already been said? By now, you surely consumed more market-related news than at almost any point in your career, and you know that this quarter was historic and unprecedented in almost every regard.

In February, equity markets were hitting all-time highs day after day. Economic data seemed great. And the world seemed focused on and entertained with the coming U.S. Presidential election.

The early spread of COVID-19 was limited to Wuhan, China, and it didn’t seem to impact U.S. equity markets much. Most of the initial concerns were about supply chain issues due to reduced or halted manufacturing in China. As the disease spread, so did panic in the market. Quarantines, travel restrictions, and mandated isolation effectively shut down large swaths of the economy.

The Federal Reserve responded quickly and powerfully, intervening in many different ways and cutting rates to essentially zero. The U.S. Government also responded with the CARES Act, a $2 Trillion package to help bridge the economic gap.

News-worthy events were happening faster than they could be digested. And the reality in which we live had changed in almost every aspect. This was a Black Swan event, and markets behaved accordingly – with incredible volatility. As if the virus-related news weren’t enough, Saudi Arabia entered into something akin to a price war with Russia. The price of crude oil plummeted with the extra supply, particularly given the unusually low levels of demand associated with COVID-19 fears and travel restrictions.

At one point in March, the S&P 500® Index had fallen over 30% from its February peak. After a sharp rally in the last week of the quarter, the index had rebounded enough to finish down 19.6%. The carnage wasn’t limited to equity markets. There were stresses in nearly every financial market.

SMALL CAP GROWTH SEPARATE ACCOUNT COMPOSITE PERFORMANCE

Perhaps it is fitting that the prior quarter was a textbook case of “risk on” and greed dominating fear. That pendulum swung as quickly as it ever has. There were no real safe havens. Large cap stocks fared better than smaller companies, and growth significantly outperformed value strategies. Many of the value constituents are cyclical and carry (now worrisome) debt.

The Russell 2000® Growth Index lost 25.76% of its value. The Stephens Small Cap Growth Composite did relatively well, falling 21.20% gross of fees (21.33% Net). We have an inherent quality bias in our portfolio and this helped our returns. Our companies tend to have less cyclicality, more profitability, and far less debt. Additionally, the portfolio management team urgently considered the risks of a pandemic, even before there were cases in the U.S. We had already started making adjustments to the portfolio in February, and we had mapped out other transactions contingent on further deterioration. This enabled us to act quickly, eliminating or reducing positions that were more exposed to the economic implications of the virus and the economic shutdown, and initiating and adding to positions which were immune or relatively well positioned for the turmoil.

Outside of Energy, Consumer stocks were the hardest hit, for obvious reasons. Consumers just aren’t able or willing to go shopping or dine out. Unemployment claims skyrocketed at the end of the quarter, and presumably will only worsen. Many retailers and restaurants simply closed their doors. We sold our position in Canada Goose Holdings fairly early in the quarter in part because of a warmer winter, but also because all of their stores in China were closed. Given the outbreaks on cruise ships and the issues there, we also eliminated our position in OneSpaWorld, Holdings, whose business is operating spas on cruise ships. We also sold our position in Monro Inc., an auto parts retailer. There were bright spots in the Consumer sector, however. We re-initiated a position in Papa John’s International, as pizza deliveries actually gained share, and the company has successfully rebranded itself after the public relations debacle over a year ago. We bought a small position in Live Nation Entertainment opportunistically as it sold off in all the volatility. Live Nation will be challenged in the near term as concerts and events are cancelled and postponed, but most of the company’s costs are variable, and they will maintain their near-monopoly status. We added to our positions in Sportsman’s Warehouse Holdings – their stores remain open and sales are robust. We also added to Wingstop, Inc. and Ollie’s Bargain Outlet Holdings, Inc. The net effect was that we outperformed the benchmark by over 100 basis points in the sector for Q1.

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1 The information is shown as supplemental only and complements the full disclosure presentation located on the back. The Russell 2000® Growth Index measures the performance of those Russell 2000® companies with higher price-to-book ratios and higher forecasted growth values. The S&P 500® Index is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. Copyright © 2020, S&P Global Market Intelligence (and its affiliates as applicable). All rights reserved. See additional information regarding S&P ratings at https://www.stephensimg.com/terms-and-conditions/. The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000® Index. You cannot invest directly in an index.
Energy was far and away the worst performing sector, getting hit on both supply and demand fronts. We already had minimal exposure to the space, but sold the last bit of our position in Core Laboratories.

Financials held up slightly better than the overall market, and we outperformed on a relative basis. We opportunistically added to our position in the debt collection industry, with Encore Capital Group. We also built up our positions in the pawn industry, with EZCORP, Inc. and FirstCash, Inc. They both stand to benefit as consumers have fewer credit options, and may be strapped for cash in the near term. MarketAxess Holdings held up very well; given the volatility and volumes in the fixed income market, their electronic trading platform presumably saw extra activity. Finally, we initiated a position in eHealth, Inc., the leading online platform for private health insurance.

Healthcare stocks were a bit of a mixed bag. We did well on a security selection basis, but because we were underweight the sector, it was a slight drag in terms of attribution. Repligen Corporation and Neogen Corporation both posted positive returns for the period. Many healthcare stocks suffered due to a crowding-out effect from all of the focus on COVID-19. Elective procedures have been put on indefinite hold. Hospital budgets may be strained. We added Teladoc Health to the portfolio. Their tele-medicine solution is quickly gaining traction as more and more people are staying home and are reluctant to go to the doctor’s office unless absolutely necessary. Even though we bought the position midway through the quarter, it was one of our top contributors to returns.

We considerably outperformed our benchmark in Industrials. Our positioning has been toward companies with secular growth stories. As a result, we are underweight the companies whose fortunes depend on the business cycle alone; and these are the stocks that suffered the most. HEICO Corporation’s exposure to air travel caused us to trim our position. The rest of our aerospace and defense holdings dramatically outperformed. Our logistics-related holdings fared relatively well. We entirely avoided the troubles with airlines and road & rail.

Although Technology is our largest sector, it didn’t have much impact on the portfolio’s relative performance from an attribution standpoint. Software companies generally sold off as market conditions deteriorated. PROS Holdings, Inc. was our hardest hit, as airlines and hotels make up a substantial amount of their customer base. We sold our position in Cornerstone OnDemand after an especially disappointing earnings result and announcing a risky acquisition with significant levels of debt. Semiconductor stocks were weak due to supply chain issues and the impending slowdown in global demand (although massive amounts of telecommuting is driving PC demand and network capacity). In a true bright spot, Five9, Inc. was our single biggest contributor to performance, and is a great example of companies that can benefit from this disruption. Five9 is the leader in cloud-based call center software, enabling employees to work remotely from home.

PORTFOLIO CHARACTERISTICS

As we dealt with a dramatically changing environment and heightened volatility, there were many more reasons and more opportunities to trade. As a result, our turnover ticked up quite a bit. We added six new positions, eliminated another six, and incrementally traded dozens more. This trading activity enhanced our returns in the quarter.

Despite the volatility, the ordinal ranking of our sector weights didn’t change. Technology remains our largest, at about 30%. Healthcare grew to nearly 24% of the portfolio, and Industrials represents just a little over 16%. We are still overweight Technology, and now Financials and Consumer too. Healthcare is still underweight, but predominantly due to our lack of ownership among unprofitable biotech companies.

Take these valuation metrics with a grain of salt. The sell-side has not revised earnings estimates to reflect the conditions that developed in the last 30 days. Even if they had tried, I don’t think they would capture the magnitude of the impending changes. Using these stale denominators, our weighted harmonic average P/E ratio on next twelve months earnings is now 22.7 times. Last quarter it was 28. The benchmark’s ratio shrank from 21 last quarter to 16.6.

Also stale, our median growth rate for the most recently reported quarter was 8% on an earnings basis and over 11% on revenues.

In a bit of a surprise, our earnings catalyst stocks outperformed our core growth stocks. Catalyst grew to 53.7% of the portfolio, while core is 46.3%. Admittedly, we saw this phenomenon in 2008/2009 as well, as the economic disruption created new catalysts.

OUTLOOK

There’s a famous quote in athletics: “You can’t coach speed.”

You can learn technique, you can build strength, and you can improve fitness, but it’s really, really hard to get fast. As an athlete, you either have speed or you don’t. And for many sports it is one of, if not the determining factor in performance.

Portfolio management is certainly not a sport. And I don’t think “speed” has ever been a criteria for any of our clients in choosing a manager. Frankly, it’s probably the opposite. Thoughtful, thorough, patient managers seem much more attractive, given the task at hand.

But sometimes, the market - or the world at large - demands speed. Now is one of those times.

“There are decades where nothing happens, and weeks where decades happen.”

- Lenin

Events are happening around the globe at an alarming speed. Market-moving events. Game-changing events. Life-or-death events. In fact, things have been changing so quickly over the last six weeks, I’m certain no one could keep up with it all. Suddenly, there is a huge premium on speed: how quickly can you obtain, consume, process, and then act on new information? And maybe more important: do you have the proper framework with which to digest this new information?

As the coronavirus situation unfolded, yesterday’s news was almost irrelevant. Speed is so important in this environment, that I’d be willing to bet that the comments I write here will be of little value in a few weeks. (Critics might say they’re of little value today!)
OUTLOOK

Before we jump in to the meat of it, I want to remind you of one important point. Many of you have heard me say this before. If you boiled down our investment philosophy into one sentence it would be this:

*Because of human nature and behavioral biases, investors chronically underestimate the magnitude and duration of change.*

It has never been more applicable than now. This is our framework! Get ready to see it everywhere (and not because of the Baader-Meinhof phenomenon).

**Part 1 – The Issues**

The health crisis is but one of the problems. As I see it today, there are at least six distinct, but intertwined issues.

1. **The global health crisis caused by COVID-19.** We are all amateur epidemiologists now, so I won’t waste time on the virus itself. We know what we are up against. I say that tongue in cheek, because part of the problem is that we don’t really know what we are up against. Problems with testing, lack of transparency, and just the novelty of it all means that we’re not quite flying blind, but we don’t have nearly as much data as we would like.

   **The change:** A particularly contagious and relatively lethal coronavirus emerges.

   **The underestimation:** It’s basically just the flu. It’s limited to China.

2. **The economic crisis resulting from fear, travel restrictions, social distancing, and all of the changes in behavior as a result of COVID-19.** We don’t have a literal medicine for this disease yet (meaning a vaccine or some effective anti-viral cocktail). We are all hoping for some innovative breakthrough on this front, but realistically it seems that a vaccine is probably at least a year away. As long as we don’t have a literal medicine, and governments want to avoid the situations of hospitals being overrun, then we will continue to take our virtual medicine – distancing and isolation. Unfortunately, the side effect of this virtual medicine is a massive shutdown of large parts of the economy.

   **The change:** A fear-driven, and in some cases government-mandated, shut down of the consumer economy.

   **The underestimation:**

   Here are the forecasts for Q2 GDP and some comments from a well-respected, veteran economist.

   3/1: 0%
   3/5: “Our forecast for zero growth in 2Q may be optimistic. But we believe it’s premature to go negative, particularly with policymakers likely to become even more aggressive.”
   3/8: -2%
   3/9: -3.5%
   3/16: -10% “When the facts change, I change. What do you do, sir? In this estimate, we are going to ‘rip the band-aid off.’”
   3/19: -20%

   (Editing note, as this was being published; this economist revised his 2Q GDP estimate to -50% on April 5.)

3. **A massive disruption in energy markets as a result of Saudi Arabia’s plans to increase production into a falling market.**

   **The change:** A poorly timed positive supply shock coincident with demand cratering.

   **The underestimation:** I yield on this one...maybe the market was in a depressed enough mood that it adjusted to this new information fairly quickly. However, just a couple of weeks after this announcement, crude oil had a negative price in certain locations.

4. **Financial market and banking stresses (I’m not sure I can use the word “crisis” here, yet), as a result of the three factors above.**

   **The change:** Massive volatility, short term U.S. rates at zero or below, liquidity problems in fixed income markets.

   **The underestimation:** This one is still playing out. Stay tuned. Maybe the steps on #5 have helped. Maybe there’s more to come.

5. **The impact of unprecedented action from the Fed and the US Government both today and long term.** I will give credit where credit is due, and I am pleasantly surprised at how quickly and decisively the Fed and the government have responded to the situation at hand. I suppose these are lessons learned from 2008-9.

   **The change:** Unprecedented QE and expansion of the Fed balance sheet. Cutting short term rates to zero. Massive fiscal stimulus which might essentially be “helicopter money.” Fed buying ETFs, corporate bonds, and munis. Ballooning debt/GDP.

   **The underestimation:** For years now, I’ve argued about the perils of negative interest rates. Now we have them here. What are the implications of all these policies? Right now, no one is even asking that question. The market is laser-focused on the virus itself, so there is no estimation. But that in itself is an underestimation of the incredible long-term ramifications of these drastic changes to the very structure of our economy. We will be talking about this for decades.

   In addition, do you think there is more to come from the Fed and from Congress? I can’t imagine that the first cut at this was enough. We have only begun to see the policy response.
OUTLOOK

6. The personal and family-related stresses of living in a world where every aspect of your life has been upended. This hasn’t gotten much attention in the financial press, but it will have an impact on the market and certainly individual stocks.

   The change: Work environment, home environment, potential illness, stress, personal economic stress, limited ability to socialize, limited recreational activities, etc.
   The underestimation: Again, it’s still too early to say on this one, but this is another situation where people are only just now asking the question.
   New habits will form; old ones will be broken. Depression will set in eventually.

Part 2 - SIMG Update

Given the disruption, I wanted to give you a brief update on the status of our firm. As of today, we are all safe and healthy. Since this will be the fourth time we have officially put our business continuity plan into effect due to hurricanes and flooding issues in the Houston area, we’re actually pretty well trained for the situation. Portfolio Managers Sam Chase, Kelly Ranucci, and I have all been working remotely. Portfolio Managers John Thornton, John Keller, and our trader, Mark Merricks have been going into the office. We’ve all been going above and beyond to practice social distancing and excellent hygiene.

As a firm, our AUM are down simply because of returns. We saw net inflows for the period. We have been able to stay 100% focused on stocks and the portfolio.

I want to take a minute to brag for just a moment. Our core philosophy and our unique process has served us very well throughout all of this change. We were very early in considering the potential disruption from COVID-19. Why? The theory of revealed preference, or at least a corollary thereof. Economist Paul Samuelson noted that you can ask people what they prefer, and they may give you an answer, but you can best judge their preferences by inference on what they actually choose. When most people were saying that the coronavirus was just like the flu, and dismissing the risks, we were watching China; not what China said, but what China did – inferring the significance and severity of the virus by studying their preferences. In this case, they chose to lock up entire cities, with healthcare workers in full hazmat suits, offering rewards to individuals who turned in their sick friends, and so on. Their actions, their preferences, revealed this to be a much more serious situation than other sources would convey.

In mid-February, we walked through the portfolios, stock-by-stock, identifying where coronavirus risk, or opportunity, might exist. This work, and our framework for processing change, allowed us to make many quick adjustments to the portfolio, nearly all of which added to our returns. I have never been more proud of the work that we have done, than I have been in the last six weeks. Even though we are concerned about the public health issues, and we hate seeing negative absolute returns, and we are still worried about the long-term economic situation, we are excited to be operating in an environment with so much alpha potential.

Part 3 – Conclusions

The market has done a lot of catching up to reality. Is it enough? I don’t think so.

I would presume that the virus situation itself is set to improve. The social distancing and travel restrictions have been in place long enough now that we should see the second derivative improve, and maybe even the growth rate itself slows. This will be welcome news, and I imagine the market will move higher when that happens.

However, it’s not purely good news from an economic or financial perspective. If the virtual medicine of shutting down the economy is effective in slowing the spread of the virus, then it means that we can’t quit taking that medicine. Returning to normal isn’t an option any time soon. The most likely path is that as the virus comes under control, then we gradually and carefully re-open aspects of the economy and everyday life. But until there is a vaccine or some easily available treatment, we won’t be able to go back to the way things were. On top of that, economic damage is being done that cannot quickly be undone. When businesses close or go bankrupt, they can’t just pick up where they left off. Even when the health concerns are behind us, it will take time to fill that gap.

Wall Street has yet to deal with the bad news. While economists are busy revising and re-revising their forecasts for GDP, analysts are doing the same thing with company earnings estimates. In a few weeks’ time, we will see Q1 earnings results, and get to hear from CEOs and CFOs. It won’t be a pretty thing for most companies. Three months thence, we get to do it again. That news won’t be good either. Maybe it’s a “buy the rumor, sell the news” type of a phenomenon. But we’ve got to get that news out of the way.
Some of the changes to personal life will stick; some out of habit, some out of necessity. When we do overcome the virus, and when the economy starts to ramp back up, it will be changed. Will consumers spend at the same rate as they did before? Will they travel as much?

The economy is forever changed, too. The relationship of interest rates with nearly all other things is non-linear. What are the implications of the world’s reserve currency offering zero yield? With debt growing and GDP falling, what will the US Debt/GDP ratio be at the end of this? How much will the debt burden reduce our potential growth? Will this event be the catalyst to bring manufacturing back to the U.S. for all things deemed essential? It seems likely. That’s another huge change.

I can’t remember a time in my career with less visibility and more change. It’s a ripe environment for active management. We won’t get everything right, but there will be winners and there will be losers, and plenty of opportunity to differentiate ourselves. This is not a rising-tide-floats-all-boats environment! Even the recovery on the other side of this crisis is likely to be very different than other recoveries. Our investment process and philosophy at SIMG revolves around change. Identifying it, and exploiting the mistakes in others’ estimations, there have never been more opportunities for us to apply our work.

On a personal note, I hope all of you are healthy and holding up well in this difficult time. As for me, I’m looking for the silver linings. I’m enjoying having all three of my children at home. When I take a break from the news and the market, I’m riding my bike, and becoming slightly less terrible at guitar. I rewatched the movie Tombstone with my family last week. And Doc Holiday’s last words to Wyatt Earp rang so true. It seems we all want to get back to a normal life.

Doc: What did you want?
Wyatt: Just to live a normal life.
Doc: There is no ‘normal’ life, Wyatt. There’s just life. Get on with it.

Earnings growth for a portfolio holding does not guarantee a corresponding increase in the market value of the holding or the portfolio. Earnings Growth is a measure of growth in a company’s net income over a specific period, often one year. Return on Equity is the amount of net income returned as a percentage of shareholders equity and measures a corporation’s profitability by revealing how much profit a company generates with the money shareholders have invested.

### Outlook

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<tr>
<th>Year</th>
<th>Total Firm Assets (millions)</th>
<th>Strategy Assets* (millions)</th>
<th>Composite Assets</th>
<th>Annual Performance Results</th>
<th>3 Yr Annualized Standard Deviation</th>
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<tr>
<td>2019</td>
<td>5,436</td>
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*Strategy Assets are shown as supplemental information as these assets include mutual fund assets which are managed within the Small Cap Growth Strategy.

The investment objectives, risks, charges and expenses should be carefully considered before investing. SIMG nor their representatives provide legal or tax advice. Please consult your tax advisor before making any decision.

There are additional risks associated with investments in smaller and/or newer companies because their shares tend to be less liquid than securities of larger companies. Further, shares of small and new companies are generally more sensitive to purchase and sales transactions involving the company’s stock and to changes in the company’s financial condition or prospects and therefore, the price of such stocks may be more volatile than those of larger company stocks. Clients’ investment results and principal value will fluctuate.

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**Small Cap Growth Separate Account Composite** contains fully discretionary accounts invested primarily in small cap growth common stock of U.S. companies. Under normal market conditions, most of the securities purchased for this composite have market capitalizations equal to or less than the largest company contained within the Russell 2000® Growth Index at the time the security was initially purchased by accounts in the composite and are securities of companies which appear to have clear indicators of future earnings growth or that appear to demonstrate other potential for growth of capital. In addition to common stock the composite may also purchase convertible and preferred stock as well as certain Exchange Traded Funds. This composite is actively managed and securities in the composite are frequently purchased and sold by the manager. For comparison purposes the composite is measured against the Russell 2000® Growth Index.

**Stephens Investment Management Group, LLC** claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Stephens Investment Management Group has been independently verified for the periods December 1, 2005 through September 30, 2019. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm’s policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Small Cap Growth Separate Account Composite has been examined for the periods October 7, 2004 through September 30, 2019. The verification and performance examination reports are available upon request.

Stephens Investment Management Group, LLC is a registered investment advisor specializing in equity investment management, specifically small and mid-capitalization growth companies. The firm maintains a complete list and description of composites, which is available upon request.

**Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Past performance is not indicative of future results.**

The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Net of fee performance is calculated using actual management fees and performance fees incurred. Prior to June 2, 2005, accounts in the composite were charged a bundled fee based on a percentage of assets under management. The bundled fee covered investment management, trading and other account expenses. Gross returns for this period are shown as supplemental information and are stated gross of all fees and transaction costs; net returns are reduced by all fees and transaction costs incurred. Policies for valuating portfolios, calculating performance, and preparing compliant presentations are available upon request.

The management fee schedule begins at 1.25% of assets under management. Actual investment advisory fees incurred by clients may vary.

The Small Cap Growth Separate Account Composite was created December 1, 2005. Performance for the period prior to December 1, 2005 occurred while the Portfolio Management Team provided services on behalf of the prior firm, Stephens Inc., and the Portfolio Management Team members were the only individuals responsible for selecting the securities to buy and sell.

Beginning September 30, 2007, composite policy requires the temporary removal of any account from the composite which incurs a client initiated significant cash inflow or outflow of 10% or more of the value of the net assets of the account in any 30 day period. The temporary removal of such an account occurs at the beginning of the month in which the significant cash flow occurs and the account re-enters the composite at the beginning of the month after the cash flow. Additional information regarding the treatment of significant cash flows is available upon request.

The annual composite dispersion is an asset-weighted standard deviation calculated for the accounts in the composite the entire year. Firm AUM does not include accrued dividends.

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**NOT FDIC INSURED**  **MAY LOSE VALUE**  **NOT BANK GUARANTEED**